Postal Rate Commission
Submitted 8/2/2004 4:18 pm
Filing ID: 41200
Accepted 8/2/2004

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268–0001

RATE AND SERVICE CHANGES TO IMPLEMENT FUNCTIONALLY EQUIVALENT NEGOTIATED SERVICE AGREEMENT WITH BANK ONE CORPORATION	Docket No. MC2004-3

RESPONSES OF THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T1-17-23)
(August 2, 2004)

The United States Postal Service hereby provides its responses to the following interrogatories of the Office of Consumer Advocate: OCA/USPS-T1-17-23, initially filed on July 15, 2004, and superceded by an errata on July 23, 2004.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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August 2, 2004

OCA/USPS-T1-17. Please refer to pages 12 and 13 of your testimony.

a. Did you perform or obtain different projections of Bank One's before- and/or after-rates volumes for the years that the NSA will be in effect? If so, please provide such projections and supporting documentation. If not, why not?

b. Did you perform or obtain (*e.g.,* from Finance) analyses of the effect of the NSA on postal finances other than the analysis contained in Appendix A of your testimony? If so, please provide such analyses and supporting documentation. If not, why not?

RESPONSE:

a. See USPS response to POIR 1, question 4.

b. I did not perform or obtain any other analyses (other than those sponsored by Bank One witness Buc (USPS-T-2) in this docket). In analyzing the NSA, I used the same method employed by witness Crum in MC2002-2. Deviations from witness Crum's technique are explained in Appendix B of my testimony. See also USPS response to POIR 1, question 4.

OCA/USPS-T1-18. Please refer to page 16 of your testimony.

a. Please assume that Bank One's Year-1 before-rates volume estimate of 571 million pieces is normally distributed. Please confirm that under this assumption, the probability that before-rates volumes in Year 1 would be greater than 571 million is 50 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.

b. Please assume that Bank One's Year-1 before-rates volume estimate of 571 million pieces is normally distributed with coefficient of variation of ten percent.
   i. Please confirm that under these assumptions, the probability that before-rates volumes in Year 1 would be greater than 571 million is 50 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.
   ii. Please confirm that under these assumptions, the probability that before-rates volumes in Year 1 would be greater than 586 million is approximately 40 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.
   iii. Please confirm that under these assumptions, the probability that before-rates volumes in Year 1 would be greater than 601 million is approximately 30 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.
   iv. Please confirm that under these assumptions, the probability that before-rates volumes in Year 1 would be greater than 616 million is approximately 22 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.

RESPONSE:

a. Confirmed only that if one assumes that Bank One's probable year one before rates mail volumes are normally distributed about a mean of 571 million, then by definition there is a 0.5 probability that before rates volume will exceed 571 million pieces.

b. Confirmed only that the probabilities assigned by the question to specific volume levels follow correctly from the parameters assumed by the question. There is no

reason to believe, however, that a probability distribution of Bank One's year one before rates volumes can be plausibly defined according to these parameters.

OCA/USPS-T1-19. Please refer to the attachment to this interrogatory and confirm that under the Commission's MC-2002-2 methodology, the stop-loss volume for Bank One would be 616.6 million pieces. If you do not confirm, please provide the correct volume and show its derivation.

RESPONSE:

Not confirmed. The attached worksheet (line 15) shows "BOC TYBR Equilibrium Solicitation Letter Volume" to be 581.6 million pieces. This appears to be incorrect, and should instead be identified as "BOC TYBR Equilibrium First-Class Mail Letter Volume." Furthermore, if Bank One were to attain volumes of 616.6 million pieces, then the expected ACS savings would be substantially larger than the $2.5 million calculated in the attached worksheet. By assuming that solicitations are a fixed proportion of Bank One's letter mail volume at all volume levels, the attached worksheet erroneously assumes that growth from 571 million pieces of mail to 616 million pieces would come predominantly from statements. If, as is likely, the volume growth prompted by the NSA will consist predominantly of solicitations, then the cost savings will be considerably larger (because statements for currently active accounts by definition tend to have addresses with a very low UAA rate). For example, if 100% of the incremental volume consists of solicitation mail, then a volume of 616.6 million pieces would produce ACS savings for letters under the NSA of approximately $3.2 million with a combined ACS savings for letters and flats of $9.5 million.

BANK ONE NSA
Stop Loss Estimate

TABLE 1
ACS Related Savings

[1]	Manual Flat Returns Unit Cost	$1.06
[2]	Manual Letter Returns Unit Cost	$0.55
[3]	Electronic Flat Returns Unit Cost	$0.45
[4]	Electronic Letter Returns Unit Cost	$0.34
[5]	BOC Return Rate - Solicitation Letters	9%
[6]	BOC Return Rate - Solicitation Flats	11%
[7]	Address Change Service (ACS) Success Rate	85%
[8]	BOC TYBR Customer Mail Volume	506,650,000
[9]	BOC TYBR Solicitation Letter Volume	29,387,000
[10]	BOC TYBR Solicitation Flats Volume	35,043,000
[11]	Solicitation Letters % of TYBR Letter Volume	5.4823%
[12]	Solicitation Flats %	100%
[13]	BOC ACS Unit Cost Savings - Letters	$0.00087234
[14]	BOC ACS Unit Cost Savings - Flats	$0.05726308
[15]	BOC TYBR Equilibrium Solicitation Letter Volume	581,600,577
[16]	Total ASC Cost Savings - Letters	$507,353
[17]	Total ASC Cost Savings - Flats	$2,006,670
[18]	Total ASC Test Year Savings	$2,514,023

TABLE 2
Discount Leakage

Volume Block			**Incremental Volume**	**Discount**	**Discount Leakage**
[1]			[2] = [1b] - [1a]	[3]	[4] = [2] * [3]
[a]		[b]			
535,000,001	to	560,000,000	24,999,999	$0.025	$625,000
560,000,001	to	585,000,000	24,999,999	$0.030	$750,000
585,000,001	to	610,000,000	24,999,999	$0.035	$875,000
610,000,001	to	616,600,577	6,600,576	$0.040	$264,023
645,000,001	to			$0.045	$0
680,000,001	to			$0.050	$0
					$2,514,023

TABLE 1

Notes & Sources

[1] USPS-T-1 (Plunkett), Appendix A, page 1
[2] USPS-T-1 (Plunkett), Appendix A, page 1
[3] USPS-T-1 (Plunkett), Appendix A, page 1
[4] USPS-T-1 (Plunkett), Appendix A, page 1
[5] USPS-T-1 (Plunkett), Appendix A, page 1
[6] USPS-T-1 (Plunkett), Appendix A, page 1
[7] USPS-T-1 (Plunkett), Appendix A, page 1
[8] USPS-T-1 (Plunkett), Appendix A, page 2
[9] USPS-T-1 (Plunkett), Appendix A, page 2
[10] USPS-T-1 (Plunkett), Appendix A, page 2
[11] = [9] / ([8] + [9])
[12] Percent of solicitation flats eligible for ACS
[13] = ([2] - [4]) * [5] * [7] * [11]
[14] = ([1] - [3]) * [6] * [7] * [12]
[15] = Table 2 [1b] - ([10] - 43,000)
[16] = [13] * [15]
[17] = [14] * [10]
[18] = [16] + [17]

TABLE 2

Notes and Sources:

[1] Request, Attachment B
[3] Request, Attachment B

OCA/USPS-T1-20. Please assume that Bank One's Year-1 before-rates volume estimate of 571 million pieces is normally distributed. Under this assumption, please confirm that the coefficient of variation of that estimate must be no greater than 4.86 percent in order for the probability of the Postal Service's not losing money to be greater than 95 percent. If you do not confirm, please provide an estimate of the maximum coefficient of variation and explain its derivation.

RESPONSE:

Not confirmed. With the parameters assumed by the question, the probability is 0.95 that volume would not exceed 616 million pieces. Based on the calculations presented in OCA/USPS-T1-19, this is the level where expected ACS savings are presumed to equal discounts paid under the terms of the NSA. Notwithstanding the errors cited in my response to OCA/USPS-T1-19, there is an even more fundamental error in the calculations offered in OCA/USPS-T1-19: they assume that the NSA will yield a net gain in contribution from new volume of zero. Even if one were to assume that Bank One would have sent 616 million pieces without the NSA, an assumption that there will be no new volume as a result of the incentives provided by the NSA is at odds with the testimony of witness Rappaport (BOC-T-1) and witness Buc (BOC-T-2). Stated otherwise, the question assumes (1) that exogenous factors would cause Before Rates volume to exceed the estimated level of 571 million pieces by a wide margin, yet would have no effect on After Rates volume, and (2) the declining block rate discounts offered in the NSA would have no effect on the volume of First Class mail entered by Bank One. Both assumptions are illogical and unsupported by any data I have seen.

I am unable to provide alternative estimates. While it would be possible to solve for a standard deviation such that expected discounts would equal expected ACS

savings, even a minimal volume response would ensure positive contribution to the Postal Service.

OCA/USPS-T1-21. Please provide an estimate, and explain its derivation, of the coefficient of variation of Bank One's

a. Year 1 volume estimate of 571 million pieces;
b. Year 2 volume estimate of 571 million pieces;
c. Year 3 volume estimate of 571 million pieces.

RESPONSE:

As commonly used, the term "coefficient of variation" normally refers to the degree of uncertainty associated with an arithmetic mean. To derive coefficients of variation for these volume estimates would therefore require an observed pattern of variation between the actual result and the forecast value. Moreover, it would imply that the methodology used to develop the observed pattern of variance was also used to produce the forecast. As the Bank One forecast was not prepared in this way, and in fact was produced solely for use in this docket, It is not possible to derive a meaningful estimate of these terms.

OCA/USPS-T1-22. Please confirm that *ceteris paribus* the coefficient of variation of a volume projection increases as one projects farther into the future. If you do not confirm, please explain.

RESPONSE:

Not confirmed. While it is not the purpose of my testimony to offer opinions on the principles of forecasting, it is my understanding that, depending on the variable that is being forecast, longer range estimates may be more reliable than shorter range estimates. For instance, commodity prices may exhibit short-term volatility while being relatively stable over longer periods. This does not necessarily mean that it is in any way easier to produce a precise point estimate in a period that is farther in the future. See also my response to OCA/USPS-T1-21. In this instance it should be pointed out that the forecasts used in this case were not produced through sampling or regression analysis, but instead incorporated business judgment from a senior Bank One executive. Moreover, the testimony of Bank One witness Buc (BOC-T-2) shows that the additional volume of First Class solicitation mail that will be generated by the proposed rate discounts is likely to be greater than the Postal Service has assumed in its financial and cost analysis in this case.

OCA/USPS-T1-23. Please confirm that 85 percent of Bank One's mail that shifts from Standard to First-Class will incur *new* electronic return costs. Please confirm that 15 percent of Bank One's mail that shifts from Standard to First-Class will incur *new* manual return costs. If you do not confirm, please explain. If you confirm, please indicate where this cost is accounted for in Appendix A of your testimony.

RESPONSE:

Not confirmed. Of the mail that shifts from Standard to First-Class Mail, I have assumed that 7.7 percent (0.09*0.85) will receive electronic returns, and 1.3 percent (0.09*.15) will be returned manually. I included costs for these First-Class Mail physical and electronic returns when calculating "Contribution from New Volume" in Appendix A of my testimony.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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August 2, 2004